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JAPAN'S RESIDENTIAL CONSTRUCTION SITUATION

Summary

Housing investment is indispensible to achieving balanced economic growth that is less dependent on public expenditures and exports. Housing construction, which grew rapidly until the first oil crisis, has been slowing as the economy grinds down. The government in response has relaxed loan conditions and re-structured the tax rates on houses and land to try to stimulate new construction to boost the depressed housing industry. Any increase in consumer spending on housing, though, will also depend on the government's ability to enhance the purchasing power of households by holding down high land prices and increasing real disposable income. While a recent housing survey shows that potential demand for new and restored residential housing is strong, the housing industry, in addition to the government actions just mentioned, will have to respond to a changing demographic market if it is to recover.

Introduction

With its policy options constrained by huge budget deficits and deepening trade conflicts, Japan had hoped for a recovery of domestic demand to spur its lagging economy. The government of Prime Minister Zenko Suzuki, which had forecast that the economy would grow by 5.2 percent in the current fiscal year (ending next March), was counting on an increase in consumer spending, especially in residential housing, to contribute to that target. Its goal of 1.3 million housing starts for FY 1982 was 13.7-percent higher than the number achieved in the previous year. However, figures released in September by the Ministry of Construction were disappointingly low, a mere 6.9-percent higher than the same month of the previous year. Thus far, housing starts for the first half of FY 1982 (April to September) amount to 607,000, 3.7-percent below FY 1981's level and are expected to reach 1.14 million for the full year, substantially below the government's original goal.

Thus, when the government revised its economic growth forecast from 5.2 percent to 3.4 percent, the sharpest cut was the reduction in the projected growth of housing investment from 10.4 percent to 2.7 percent. Questions now being raised about housing investment, which continues to stagnate despite government expectations, indicate that there is a growing conviction that structural changes have occurred recently that affect demand for housing.

The Importance of Housing Investment

Housing demand has played an important role in Japan's economic growth. The ratio of residential construction to gross national product (GNP) rose from 5.7 percent in 1965 to 8.4 percent in 1973, and thereafter has held at around 6-to-7 percent. When related components are added in, including interior furnishings, appliances, gardens, maintenance and repair costs and resale of older homes, the Ministry of International Trade and Industry (MITI) estimates that in FY 1980 total demand was about 12 percent of GNP.

A very high priority should be placed on housing investment since its substantial share of GNP could take up the slack in the economy, since further expansion of exports is precluded by threatened protectionism and public spending is prevented by high budget deficits. Moreover, when the balance between savings and investment is taken into account, the way in which Japan's high rate of personal savings is absorbed is a very important element in economic management. Since it is again not feasible to absorb the savings through an increase in trade surpluses and/or government expenditures, housing investment becomes even more important.

Finally, a growth in housing demand could also help ameliorate trade friction by reversing the recent decreases in log and lumber imports from the United States that have resulted from the depression in the Japanese housing market. U.S. exporters will also have to adapt future shipments to the changing demographic market.

Developments in Residential Housing

Before the first oil crisis, the housing stock grew by leaps and bounds, keeping pace with the country's rapid economic growth. Housing starts recorded a 9.8-percent average growth rate, rising from 0.9 million units in 1965 to a peak of 1.9 million units in 1973 (see Table 1). An insufficient number of residential dwellings, due not only to the war but also to urbanization in the postwar period, prompted a sharp increase in homebuilding. Because adequate replacements had been neglected, the resulting growth rate was striking. Until 1973, the number of single-family households showed the largest increase as the population flowed into the three major metropolitan areas — Tokyo, Osaka and Nagoya. These social and structural factors accelerated housing investment until by 1973, the number of dwellings per household amounted to 1.05.

With the country in a slump after the first oil crisis, housing starts dropped to 1.3 million units, down 28.5 percent over the previous year. There was some improvement beginning in 1975, with starts stabilizing at around 1.5 million units until 1979. But since 1980, annual construction starts have decreased sharply and were down to 1.1 million units in 1981. Further declines are expected in 1982.

Housing starts are likely to register even further declines as the rapid aging of Japan's population cuts into the growth rate of individual households and urban migration loses its momentum. In addition, the deflationary effect of the two oil crises and the rapid improvement in the housing stock must be taken into account. Clearly then, although the quantitative demand for housing might have been satisfied, a second question remains as to whether the quality of housing is adequate. Indications are that the answer is no. The average age of residential housing was 14.6 years in 1973, but slowed rates of growth have resulted in an aging of housing stock to 15.5 years in 1982, which will fall further to an estimated 16 years in 1983.

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The 1978 housing census (conducted every 5 years) reveals that 38.9 percent of households feel their current housing situation is inadequate. This figure is higher in Tokyo (42.2 percent) and Osaka (43.2 percent), where high land prices restrict the size of homes. Although the average floor space of a new house is 40 percent larger than older units, size is still the most common complaint registered by the respondents. According to the survey, more than 40 percent of the 19.3-million privately-owned homes and more than 80 percent of the 12.7 million tenant-occupied dwellings were below the average housing level.

Investment Problems

Inadequate Structures — Replacement of inadequate structures is one of the most pressing problems in Japan today. The 1978 survey places the average home's floor space at 80.3 square meters, although figures for residences in the Tokyo and Osaka areas are considerably less, 61.5 square meters and 68.3 square meters, respectively. Moreover, the ratio of below-average housing was 71.3 percent in Tokyo and 67.6 percent in Osaka, far above the 58.3-percent figure given for the country as a whole. In general, these figures are a function of the higher ratio of rented houses in metropolitan areas; 49.9 percent in Tokyo, compared with 39.4 percent elsewhere. Also, 85 percent of housing is built of wood, and as a consequence, is vulnerable to fire or earthquake damage.

Many of these low-quality homes were built at a time when population growth of the three big metropolitan areas was expanding rapidly. Rapid urbanization had brought industry as well, and by 1979 about 60 percent of Japan's largest corporations had headquarters in the Tokyo area. Tokyo also housed 37 percent of all university professors as well as 45 percent of all college students. In order to house this large population, traditional wooden single-family units were built, leading to suburban sprawl. This created many inadequacies in the infrastructure that were unable to be filled because of a shortage of local government financial resources. Since this situation has not improved, the redevelopment of these urban areas is necessary. For example, in the Tokyo metropolitan area where the shortage is most acute, the average size of a housing unit is well below the Japanese government's recommended capacity. It is clear that it is necessary to replace these dilapidated houses with high-rise apartment buildings and improve the infrastructure to conform with the density and sanitary requirements needed in large cities.

Land Problems — Residential land has steadily grown more expensive, particularly in urban areas. The National Land Agency (NLA) said that the increase in 1982 was 6 percent higher than a year earlier, slowing somewhat from the 7.2-percent rise in the preceding six months. This compares to a 3.2-percent rise in overall consumer prices for the period. Housing officials predict that prices will flatten out, but the declining supplies of residential land and the continuation of extremely high prices will not constitute a favorable environment for housing construction.

Another serious problem concerns the availability of residential land. One proposal now under discussion calls for the government to issue public bonds to buy land from private owners in metropolitan areas. The bond would be exchanged for land at current market value and could be traded in the open market. The purchased property would then be sold to local governments or private real estate developers, thus returning money to a special account to redeem the bonds while guaranteeing the owners the profits that they are reluctant to forego.

Purchasing Power Down — As Table 3 shows, the purchasing power of households is down. This decline is reflected in the reduced amount of land sold in the last decade. In the three big metropolitan areas, 19,500 acres changed hands in 1972, compared with

only 9,000 acres in 1980. Since 1978, the price of an apartment has risen from 4.2 times to 5 times the average household's annual income, while the ratio for homes has gone up from 5.5 to 6.5. As prices have gone up, lenders have required larger down payments. At one time a borrower could finance 97.5 percent of the purchase of an apartment and 69.7 percent of a house, but current mortgages cover only 81.2 percent for apartments and 58.1 percent for houses. Assuming a 7-percent increase in annual income and a 6-percent hike in housing prices, the Mitsui Real Estate Development Co. predicts little improvement in the purchasing power of households.

Legal and Tax Issues — Most of the land that is zoned for residential use has been developed, making further expansion more difficult. However, private companies and speculators do hold possible residential land on which construction is currently restricted under various government programs pertaining to agricultural policy and local government administration. These tracts could be transferred to residential categories and developed to help solve the problems of the large urban population.

The current legislation on leased housing and land, which dates from 1921, is still another one of the principal causes of the housing shortage. Leases are renewed automatically, for example, if there is no compelling reason for cancellation on the owners part, or complaints by the tenants. But, in fact, it is so difficult to evict tenants that many houseowners leave property vacant rather than risk losing access to their homes. Construction of multi-family units for rental property is similarly constrained by these outdated leasing laws. A new legal framework for leases that encourage rather than discourage housing construction is badly needed.

Local governments contribute in other ways to the shortage by stipulating that private developers must provide a substantial percentage of the necessary infrastructure, amounting to as much as 40-to-60 percent of the total cost of the project. It also often takes more than two years to get approval for housing construction, which increases the price. In response to these difficulties, the Ministry of Construction and the Ministry of Home Affairs recently proposed relaxing these regulations.

Yet another part of the problem has to do with the tax treatment of real estate in Japan. For example, capital gains accrued from the sale of land have been subject to a high tax applicable to short-term gains. Under the 1982 tax reform law, profits from sales where the property has been held for more than 10 years will be taxed under provisions for long-term gains, which carries a lower tax rate. A second provision, designed to provide an incentive for owners of agricultural land to sell their holdings, increased the tax rate on agricultural land within urban areas to the same level as residential land. A loophole was included, though, that states a farmer who intends to use the land for agricultural purposes beyond ten years will be taxed according to the previous low rates. As a result, about 90 percent of the applicable agricultural land has been so registered — virtually eliminating any benefits from this part of intended reforms under this law.

Home Loans

Financing for homeowners is available from private financial institutions, which have displayed considerable interest in residential mortgages to offset the post-oil crisis decline in loan demand from the corporate sector. As a result, home loans rose from ¥2,658 million ($10 million) in 1968 to ¥8,514 million ($32 million) in 1973, an increase of 3.2 times. Home builders in Japan have also tied up with financial institutions to offer mortgage loans for new houses. This has spurred sales and increased home loan volumes. In recent years, financial institutions have established home financing companies, which has also facilitated home ownership.

After several years of growth in loans from private financial institutions, the share of these loans to the total balance of home loans has been declining in favor of lending from public corporations such as the Housing Loan Corp. (HLC). The HLC was established in 1950 to offer government-financed housing loans to supplement the loans of private financial institutions. Interest rates are below those available from the private mortgage market, and vary according to the size of the house. Currently, the HLC charges from 5.5 percent to 7.3 percent, rising after the eleventh year of repayment to 7.3 percent, while the bank rate is 8.46 percent. As the data in Table 4 shows, the HLC has been steadily increasing its share in housing investment and has served as an outlet for government-financed stimulus measures during economic downturns. With the sharp decline in construction recently, the HLC has raised the ceiling on loans and repairs, relaxed restrictions on the income levels of loan recipients, and made loans available for an additional 30,000 houses.

Outlook

The government now predicts 1.14 million housing starts in FY 1982, but the housing industry is more pessimistic, in part because of what it calls the excess inventory of new condominium apartments and homes. Because housing construction is correlated with the generally depressed economic conditions, the industry does not expect a prompt recovery. Whether housing investment will recover when the economy revives depends on several factors. First, the current slump is structural as well as cyclical, as noted earlier. Table 2 shows that the increase in the number of households has stabilized and may even decline in the future. A second consideration is that the influx of population into large cities has declined. These demographic factors are an indication that the demand for housing will continue to abate.

Still, counterbalancing the demographic trends, the government's housing survey shows 40 percent of all Japanese households are dissatisfied with their current housing situation and intend to either replace or alter their dwellings. Individual homeowners and renters want larger homes and a better residential environment. Meeting these criteria will mean enlarging the supply of available land for development and making efficient use of existing residential land. This will require a review of existing government controls and tax policies, as mentioned above. Residential repairs and improvement of older houses are areas of increasing significance because of the high cost of construction materials and land prices. The annual number of these projects will be boosted from 300,000 in 1981 to an estimated 600,000 by 1990. This activity should persuade the housing industry to emphasize this segment of the market. But even if all these conditions are met and the economy rebounds, it is unlikely that a housing boom as marked as that of 1972-73 will be generated because of structural changes in housing demand.

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Table 1: Residential Construction Starts by Funding Source

(units)

Year	Total	Owner-Built		Developer-Built		Built for Sale by Housing Corporation	Private Rental		Public Rental	
		Private Funds	Housing Loan Corporation	Private Funds	Housing Loan Corporation		Private Funds	Housing Loan Corporation	Local Governments	Housing Corporation
1970	1,484,556	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1971	1,463,760	483,543	120,217	118,342	38,315	7,471	409,486	28,744	90,738	62,781
1972	1,807,581	547,137	127,212	205,797	34,799	5,710	559,231	29,627	121,160	80,546
1973	1,905,112	592,689	155,803	312,822	41,088	6,173	543,679	25,788	98,599	22,906
1974	1,316,100	483,255	189,355	176,093	43,781	9,663	232,522	16,892	73,674	26,979
1975	1,356,286	499,985	200,932	177,645	52,627	17,179	249,592	19,331	77,675	25,548
1976	1,523,844	520,907	190,514	242,580	45,938	11,425	342,825	33,473	69,058	25,152
1977	1,508,260	459,838	217,373	297,564	44,467	10,740	303,922	36,867	71,335	26,049
1978	1,549,362	375,223	352,597	270,574	65,906	8,157	289,949	46,805	73,598	22,287
1979	1,493,023	353,899	343,541	244,199	88,394	14,160	274,633	46,512	66,006	20,862
1980	1,268,626	301,721	293,011	213,549	95,562	12,128	197,704	35,811	62,081	17,710
1981	1,151,699	259,778	290,656	157,857	85,951	21,121	186,925	33,139	62,432	16,035

Source: Ministry of Construction

Table 2: Population Trends

(in thousands)

Year	Households		Marriages		Population in Three Metropolitan Areas*	
	Number	Percent Change	Number	Percent Change	Number	Percent Change
1970	27,869	---	1,029	---	45,580	---
1971	29,146	4.6%	1,091	6.0%	46,625	2.3%
1972	30,385	4.3	1,100	0.8	47,640	2.2
1973	31,908	5.0	1,072	-2.5	48,741	2.3
1974	32,678	2.4	1,000	-6.7	49,450	1.5
1975	33,310	1.9	942	-5.9	50,288	1.7
1976	33,910	1.8	872	-7.4	50,849	1.1
1977	34,380	1.4	821	-5.8	51,365	1.0
1978	34,859	1.4	793	-3.4	51,870	1.0
1979	35,350	1.4	789	-0.5	52,321	0.9
1980	35,831	1.4	775	-1.8	52,741	0.8
1981	36,347	1.4	777	0.3	53,194	0.9

*Tokyo, Osaka and Nagoya.

Source: Prime Minister's Office

Table 3: Personal Income, Loanable Funds and Value of Housing

(in millions of yen)

Condominium Apartments

Year	Annual Personal Income (A)	Loanable Funds* (B)	Value of Housing (C)	C/A	B/C
1972	¥2.01	¥7.00	¥7.69	3.83	91.0
1973	2.39	8.71	11.71	4.91	74.4
1974	2.83	10.71	16.57	5.86	64.6
1975	3.27	12.65	15.30	4.68	82.7
1976	3.61	14.00	16.30	4.52	85.9
1977	4.00	15.49	16.46	4.12	94.1
1978	4.12	16.68	17.11	4.15	97.5
1979	4.42	18.08	19.92	4.48	90.8
1980	4.93	19.89	24.77	5.03	80.3
1981	5.27	21.25	26.16	4.96	81.2
1982†	5.64	22.92	27.73	4.92	82.7
1983†	6.04	24.24	29.39	4.87	82.5
1984†	6.46	25.64	31.16	4.82	82.3

Single-Family Homes

Year	Annual Personal Income (A)	Loanable Funds* (B)	Value of Housing (C)	C/A	B/C
1972	¥2.01	¥6.78	¥10.76	5.36	63.0
1973	2.39	8.34	16.34	6.85	51.1
1974	2.83	9.96	21.17	7.49	47.1
1975	3.27	11.63	21.10	6.45	55.1
1976	3.61	13.02	20.07	5.56	64.9
1977	4.00	14.59	22.27	5.57	65.5
1978	4.12	15.67	22.48	5.45	69.7
1979	4.42	16.69	25.95	5.83	64.3
1980	4.93	18.32	31.43	6.38	58.3
1981	5.27	19.78	34.04	6.46	58.1
1982†	5.64	21.14	36.08	6.40	58.6
1983†	6.04	22.60	38.25	6.34	59.1
1984†	6.46	24.15	40.54	6.28	59.5

*Savings, Housing Loan Corp. and private financial institutions.

†Estimated.

Source: Mitsui Real Estate Development Co., Ltd.

Table 4: Value of Home Loans

Value in Millions of Yen	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Public Funds	¥2,658	¥1,106	¥1,373	¥1,661	¥2,389	¥3,339	¥4,524	¥5,738	¥7,390	¥10,142	¥13,106
Housing Loan Corp.	886	863	1,085	1,342	1,963	2,744	3,722	4,677	6,287	8,461	10,688
Private Funds	1,773	2,545	4,274	6,853	9,080	11,890	15,636	19,418	23,418	27,581	30,764
City Banks	225	366	744	1,347	1,806	2,437	3,201	3,911	4,715	5,481	6,031
Regional Banks	220	331	648	1,127	1,516	2,074	2,812	3,519	4,296	4,930	5,351
Trust Banks	16	42	49	74	105	128	157	183	206	229	238
Long-Term Credit Banks	49	69	80	101	132	173	226	289	378	444	510
Mutual Banks	92	138	320	589	800	1,103	1,462	1,784	2,142	2,505	2,723
Trust and Savings Associations	259	374	684	966	1,200	1,563	2,127	2,597	3,087	3,657	3,995
Agricultural Coops	332	445	532	730	985	1,136	1,335	1,483	1,523	1,639	2,028
Total	2,658	3,651	5,647	8,514	11,469	15,230	20,161	25,155	30,809	37,722	43,870
Percentage Distribution											
Public Funds	33.3%	30.3%	24.3%	19.5%	20.8%	21.9%	22.4%	22.8%	24.0%	26.9%	29.9%
Housing Loan Corp.	26.3	23.6	19.2	15.8	17.1	18.0	18.5	18.6	20.4	22.4	24.4
Private Funds	66.7	69.7	75.7	80.5	79.2	78.1	77.6	77.2	76.0	73.1	70.1
City Banks	8.4	10.0	13.2	15.8	15.7	16.0	15.9	15.5	15.3	14.5	13.7
Regional Banks	8.3	9.1	11.5	13.2	13.2	13.0	13.9	14.0	13.9	13.1	12.2
Trust Banks	0.4	1.1	0.9	0.9	0.9	0.8	0.8	0.7	0.7	0.6	0.5
Long-Term Credit Banks	1.8	1.9	1.4	1.2	1.2	1.1	1.1	1.1	1.2	1.2	1.2
Mutual Banks	3.5	3.8	5.7	6.9	7.0	7.2	7.3	7.1	7.0	6.6	6.2
Trust and Savings Associations	9.7	10.2	12.1	11.3	10.5	10.3	10.6	10.3	10.0	9.7	9.1
Agricultural Coops	12.5	12.2	9.4	8.6	8.6	7.5	6.6	5.9	4.9	4.3	15.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank of Japan and Housing Loan Corporation